

# Revenue Estimates

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## General Fund Revenues

Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior tax years. Penalties were waived for taxpayers who applied for amnesty during the amnesty period of February 1, 2005 to March 31, 2005. Although they had to apply within this time frame, taxpayers have until the end of May 2005 to submit their tax returns and pay amounts owed. At the conclusion of amnesty, taxpayers who could have applied for amnesty but didn't are subject to higher penalties if found to owe additional amounts for amnesty years.

The effect of amnesty on the accounting for General Fund Revenues has been distortive. This is because amnesty payments made for years before the current year are accounted as a "prior year adjustment" to the current year, rather than carried back to those earlier years which are now closed. And much of the money that came in during the amnesty period was in the form of protective payments—amounts submitted to avoid the extra penalty, but that would have come in any way in future years, or that will prove not to have been due at all, as some taxpayers will win their disputes. These amounts will lower revenue estimates in the current year, budget year and beyond—even though they apply to payments received that are accounted for as "prior year adjustments."

We can estimate that the state will gain about 5 percent of the funds submitted as protective claims that it would not otherwise (later) have received. That yields about \$200 million more than was expected in January, measured over both the current year and the budget year.

The most important component of change in General Fund estimates is more traditional: the effect of economic growth on personal income tax, corporation tax, sales tax, and other tax revenues. As will be detailed more precisely below, greater personal income tax growth in the current year, greater corporate tax growth in the budget year, and lower sales tax revenues in the current year, all compared with January, yields about \$3.7 billion more in revenue.

The conclusion is that the General Fund has about \$3.9 billion more in one-time revenue over the 2004-05 and 2005-06 time periods. However, we must caution that the accounting rules require reporting \$4.8 billion—since \$900 million is expected to reduce revenues in years after the budget year. It will be essential to create a notation on the state's surplus account in the nature of escrow to hold that \$900 million until the amount to be paid back to taxpayers in future fiscal years has been settled and the remainder can be prudently used.

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The May Revision estimates represent a gain of \$2.2 billion in the current year from the time that the 2004-05 budget was enacted. In addition, the increase in revenue in 2005-06 is another \$4.4 billion, for a two-year gain of \$6.6 billion.

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### Personal Income Tax

The personal income tax forecast has been increased by \$2.367 billion in 2004-05 and by \$319 million in 2005-06. The current year estimate includes about \$480 million in revenue acceleration due to the amnesty program, which will be a prior year adjustment since these collections are attributable to several prior tax years. The budget year estimate includes \$200 million in additional amnesty receipts that are expected to come in as installment payments. The due date for amnesty payments is May 31, 2005. Those with an installment agreement, however, have until June 30, 2006, to pay their outstanding liability and interest.

General Fund collections received in April and the first days of May, when final payments for the 2004 tax year were due, were \$1.2 billion over the Governor's Budget forecast, which suggests that taxable income was stronger than expected for the year. The 2003 tax data indicate higher income and liability growth for taxpayers with adjusted gross income over \$100,000 than for those with income under \$100,000. The forecast assumes that this growth distribution continued in 2004. In addition, this forecast estimates that capital gains income growth in 2004 was 32.5 percent; which is on top of the 34 percent growth that occurred in 2003. We believe net capital gains, including stock option income, are primarily responsible for the 2004-05 increase. Capital gains income in 2005 is expected to continue posting growth but at a more moderate rate of 5 percent.

The Financial Accounting Standards Board has issued a regulation which will require expensing of employee stock options on company financial statements. This is expected to diminish the use of stock options and result in a loss of revenue. This forecast incorporates a reduction in revenue of \$30 million in 2006-07, \$130 million in 2007-08, and \$230 million annually thereafter due to this factor.

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### Sales and Use Tax

The sales and use tax forecast has been decreased by \$75 million in the current year and increased by \$4 million in the budget year. Through March, sales tax receipts were slightly below the 2005-06 Governor's Budget estimate and the May Revision forecast anticipates that only a portion of this shortfall will be recovered over the remainder of the year.

Current law specifies that certain state revenues from the sales tax on gasoline and diesel fuel sales be transferred to the Public Transportation Account (PTA). The Governor's Budget proposed to maintain the base level of transfers to the PTA, but specified that any excess sales tax revenues on gasoline, which would otherwise be designated as PTA "spillover," be credited to the General Fund for 2005-06. This is expected to increase General Fund revenues by \$380 million in 2005-06, an increase of \$165 million from the Governor's Budget, due to higher gasoline and diesel prices.

## Corporation Tax

Largely because of the accounting rules for amnesty, the corporation tax forecast has been decreased by \$1.117 billion in 2004-05 and \$198 million in 2005-06. The profits outlook is somewhat better for 2005-06 than estimated in January. Without the accounting effect of amnesty-related revenues, projected 2005-06 revenues from this tax would be above the Governor's Budget forecast by about \$1 billion. However, the forecast changes primarily reflect higher refunds and lower payments due to the large protective payments submitted by corporations in the current year. The cash gains in 2004-05 are accounted for as a prior year adjustment because these gains are for tax years 2002 and prior.

Figure REV-01

GENERAL FUND REVENUE FORECAST				
Reconciliation with the 2005-06 Governor's Budget				
(Dollars in millions)				
Source	Governor's Budget	May Revision	Change Between Forecasts	
<b>Fiscal 03-04</b>				
Personal Income Tax	\$36,399	\$36,399	\$0	0.0%
Sales & Use Tax	23,847	23,847	0	0.0%
Corporation Tax	6,926	6,926	0	0.0%
Insurance Tax	2,115	2,115	0	0.0%
Other Revenues	4,762	4,762	0	0.0%
Transfers	713	713	0	0.0%
<b>Total</b>	<b>\$74,762</b>	<b>\$74,762</b>	<b>\$0</b>	<b>0.0%</b>
<b>Fiscal 04-05</b>				
Personal Income Tax	\$39,527	\$41,894	\$2,367	6.0%
Sales & Use Tax	25,168	25,093	-75	-0.3%
Corporation Tax	8,678	7,561	-1,117	-12.9%
Insurance Tax	2,230	2,230	0	0.0%
Other Revenues	2,301	2,478	177	7.7%
Transfers	315	239	-76	-24.1%
<b>Total</b>	<b>\$78,219</b>	<b>\$79,495</b>	<b>\$1,276</b>	<b>1.6%</b>
Change from Fiscal 03-04	\$3,457	\$4,733		
% Change from Fiscal 03-04	4.6%	6.3%		
<b>Fiscal 05-06</b>				
Personal Income Tax	\$42,895	\$43,214	\$319	0.7%
Sales & Use Tax	26,947	26,951	4	0.0%
Corporation Tax	9,015	8,817	-198	-2.2%
Insurance Tax	2,300	2,300	0	0.0%
Other Revenues	2,071	2,384	313	15.1%
Transfers	544	201	-343	-63.1%
<b>Total</b>	<b>\$83,772</b>	<b>\$83,867</b>	<b>\$95</b>	<b>0.1%</b>
Change from Fiscal 04-05	\$5,553	\$4,372		
% Change from Fiscal 04-05	7.1%	5.5%		
Three-Year Total			\$1,371	

These figures exclude \$3.885 billion which will be a prior year adjustment.